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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

HERITAGE CAPITAL CORPORATION; NORTH RIVERSIDE VENTURE INC.; AND VENTURTECH II, LIMITED PARTNERSHIP,

Petitioners,

v.

DELOITTE HASKINS & SELLS,

Respondent.

Brief In Opposition To Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

BRIEF IN OPPOSITION

Of Counsel:

BARBARA A. MENTZ
Associate General Counsel
DELOITTE & TOUCHE
1633 Broadway, 9th Floor
New York, NY 10019-6754
(212) 492-3884

JAMES T. WILLIAMS, JR.*
JEFFREY E. OLEYNIK
DANIEL M. SROKA
BROOKS, PIERCE, MCLENDON, HUMPHREY & LEONARD
Suite 2000 Renaissance Plaza
230 North Elm Street (27401)
Post Office Box 26000
Greensboro, NC 27420
(919) 373-8850

Attorneys for Respondent
**Counsel of Record*

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

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QUESTIONS PRESENTED

1. IS AN AUDITOR'S REPORT TO A CLOSELY HELD COMPANY WHICH THE AUDITOR KNOWS AND INTENDS TO BE SOLELY FOR THE BENEFIT OF ITS CLIENT DEEMED TO BE A REPRESENTATION BY THE AUDITOR TO ALL POTENTIAL FUTURE INVESTORS OF THE AUDIT CLIENT FOR PURPOSES OF A CLAIM OF A PRIMARY VIOLATION UNDER SECTION 10(b)?

2. CAN THERE BE AIDING AND ABETTING LIABILITY UNDER SECTION 10(b) WHERE THE DEFENDANT OWED THE PLAINTIFF NO FIDUCIARY OR OTHER DUTY AND DID NOT TAKE ANY AFFIRMATIVE ACTION TO ASSIST THE ALLEGED PRIMARY VIOLATION?

LIST OF PARTIES TO THE PROCEEDINGS IN THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Deloitte Haskins & Sells is now known as Deloitte & Touche.

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HERITAGE CAPITAL CORPORATION; NORTH RIVERSIDE VENTURE INC.; and VENTURTECH II, LIMITED PARTNERSHIP,

Petitioners,

v.

DELOITTE HASKINS & SELLS,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Respondent Deloitte Haskins & Sells respectfully submits this Brief in Opposition to the Petition for a Writ of *Certiorari* to review the opinion of the United States Court of Appeals for the Fourth Circuit in *Heritage Capital Corporation; North Riverside Venture Inc.; and Venturtech II, Limited Partnership v. Deloitte Haskins & Sells*, (No. 92-1788, 4th Cir. 1993) because the Petition does not present any special and important reasons that warrant review by this Court.

STATEMENT OF THE CASE

Petitioners commenced this action by filing a complaint on December 31, 1988, in the United States District Court for the Eastern District of North Car-

olina. The complaint alleged that Respondent, Deloitte Haskins & Sells ("DH&S"), an independent accounting firm which had audited certain year-end financial statements prepared and issued by Learning Resources, Inc. ("LRI"), violated Section 12(2) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78(j)(b), and Rule 10b-5 promulgated thereunder (hereinafter referred to as the "Section 10(b) claims"). The complaint further alleged that DH&S was liable for violating Section 78A-56 of the North Carolina Securities Act and for common law fraud, breach of contract, professional negligence and breach of fiduciary duty.

On October 3, 1991, the District Court granted DH&S' motion for summary judgment on Petitioners' federal securities law claims, holding that (i) their Section 12(2) claims were time-barred by the statute of limitations set forth in Section 13 of the 1933 Act, and (ii) their Section 10(b) claims were time-barred by application of this Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,* 111 S. Ct. 2773, 115 L.Ed.2d 321 (1991).

In January, 1992, DH&S moved for summary judgment on Petitioners' state law claims and Petitioners simultaneously moved for summary judgment with respect to their negligent misrepresentation and third party beneficiary breach of contract claims. In an order dated April 1, 1992, the District Court concluded that there were no genuine issues of material fact and granted DH&S' motion on all state law claims (and concomitantly denied Petitioners' motion), holding that:

1. DH&S did not owe a duty to Petitioners under North Carolina law governing Petitioners' neg-

ligent misrepresentation and third party beneficiary breach of contract claims because there was no evidence that DH&S intended or knew that its audit work would be relied upon by anyone other than its audit client, LRI. Appendix to Petition at 26a, 29a, 30a, 34a.

2. There was no evidence that DH&S engaged in any conduct with the scienter necessary to maintain an action for common law fraud under North Carolina law. Appendix to Petition at 35a.

3. There was no evidence that DH&S engaged in any conduct with an intent to influence or control Petitioners' investment decisions; consequently, there was no basis under North Carolina law to establish that DH&S owed Petitioners a fiduciary duty. Appendix to Petition at 37a.

4. There was no evidence that DH&S acted with a conscious intent or a specific motivation to assist an alleged fraud by LRI, and thus no evidence to maintain a claim against DH&S under North Carolina securities laws. Appendix to Petition at 39a.

Subsequent to the District Court's August 31, 1991 order granting DH&S' motion for summary judgment on Petitioners' federal securities claims, the United States Congress enacted legislation addressing the *Lampf* decision. *See* 15 U.S.C. §78aa-1. In response, the District Court reinstated the Section 10(b) claims on February 3, 1992. In March 1992, DH&S moved for summary judgment on these claims. DH&S' motion was granted by the District Court on May 15,

1992. The District Court, in addition to its findings set forth in its April 1st order, found that:

1. DH&S did not know at the time it prepared the audit reports that new investors, such as Petitioners, were being solicited. Appendix to Petition at 12a.
2. DH&S had no dealings or interaction with Petitioners, and did not in any way encourage or solicit Petitioners' investments in LRI. Appendix to Petition at 13a.
3. There was no evidence that DH&S had an intent to deceive, manipulate, or defraud anyone. Appendix to Petition at 14a.

Petitioners appealed to the United States Court of Appeals for the Fourth Circuit all of the District Court's summary judgment rulings in the April 1 and May 15, 1992 orders, with the exception of that portion of the April 1st order which held that DH&S did not owe Petitioners a fiduciary duty. In a *per curiam*, unpublished opinion dated April 30, 1993, the Fourth Circuit affirmed each of the District Court's rulings based on the District Court's opinions, and on May 21, 1993, issued its mandate. On July 29, 1993, Petitioners filed with this Court a petition for writ of *certiorari* solely with respect to the May 15th order and the affirmance by the Fourth Circuit of the grant of summary judgment as to Petitioners' Section 10(b) claims.

REASONS FOR DENYING THE WRIT

There are two fundamental reasons why the Petition does not present any special and important issues that warrant review by this Court. First,

Petitioners have not claimed that either the District Court or the Fourth Circuit misapplied this Court's decisions regarding the appropriate standard for granting summary judgment. Petitioners simply failed to establish the facts necessary to support the requisite elements of either a primary or an aiding and abetting claim under Section 10(b). Accordingly, Petitioners failed to convince either court below that there was a genuine issue of material fact with respect to any issue pertinent to DH&S' alleged liability under Section 10(b). The District Court, properly applying the summary judgment standards enunciated by this Court, therefore entered summary judgment in favor of DH&S on all claims. The Fourth Circuit, in a *per curiam*, unpublished opinion affirmed the judgments below based upon the District Court's findings of fact and conclusions of law. Petitioners' request to this Court to engage in a third review of the now worn factual record emphasizes the paucity of significant legal issues of this case.

Second, the courts below granted and upheld summary judgment on the basis of established precedents from this Court and applications of those precedents by the Circuit Courts. Petitioners' Section 10(b) claims against DH&S as a primary violator failed because there was no evidence that DH&S ever made any representation to Petitioners. The absence of this critical element compelled a finding that the primary Section 10(b) claims against DH&S were fatally deficient. Similarly, Petitioners' Section 10(b) claims based on aider and abettor liability failed because there was no evidence that DH&S owed Petitioners any duty or that DH&S possessed the requisite intent to deceive anyone. The established rule in the Circuit Courts is

that absent a duty to disclose or affirmative action to assist a primary violation, there can be no aider and abettor liability under Section 10(b) unless the defendant possessed a specific and conscious intent to deceive—*i.e.*, the defendant consciously assisted the alleged primary fraud—a level of scienter which the District Court and Fourth Circuit found to be utterly lacking here. Quite simply, the holdings of the District Court, as affirmed by the Fourth Circuit, were squarely based on this Court's Section 10(b) decisions and the consistent application of those decisions by the lower appellate courts.

Having found the existing law fatal to their claims, Petitioners ask this Court, in essence, to imply a right of action under Section 10(b) which would make an auditor the insurer of every investment which, at some time in the future, might be made in its audit client. This unprecedented and unworkable approach, which would expand the universe of potential plaintiffs, would not only expose professionals who have relationships with securities issuers to virtually unlimited liability, but ultimately would endanger the viability and advisability of professionals providing services to such issuers.[1] No authority, let alone a split of authority, exists in the Circuit Courts to support this expansive approach to Section 10(b).

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[1] The Seventh Circuit has discussed the undesirable economic effects of such open-ended liability:

> Duties to disclose or pay damages would raise the costs of all audits, as accountants increased fees to cover anticipated liabilities. Honest enterprises would pay these fees no less than dishonest (for until the audit ended, an accountant could not tell which was which). So firms would purchase less accounting ser-

In sum, this case presents no special and important reason why this Court should grant *certiorari*, since the District Court entered, and the Fourth Circuit affirmed, summary judgment in favor of DH&S based on the undisputed facts and a straightforward application of controlling law.

A. The Courts Below Properly Applied The Standard For Summary Judgment And Found That Petitioners Failed To Establish The Basic Elements Of Either A Primary Or Secondary Section 10(b) Claim.

The District Court correctly applied the standards for summary judgment established by this Court in reaching its conclusions that DH&S neither committed, nor aided and abetted, a primary violation under Section 10(b). Appendix to Petition at 21a-22a, citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986); and *Celotex Corp. v. Catrett*, 477 U.S. 317, 327 (1986). Petitioners now ask for a third review of the facts by this Court. That is not the purpose of *certiorari*.

Petitioners use a significant part of their Petition to state allegations which they say are derived from the summary judgment record. Petition at 3-9. What appears in the Petition, however, is not supported by the record. Rather, it is a discursive statement of arguments and contentions about the conclusions that they would like to have been drawn from undisputed facts that were before the District Court. They have

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vices, and investors in all firms would lose at both ends: the price would go up as the amount of oversight went down.

DiLeo v. Ernst & Young, 901 F.2d 624 (7th Cir.), *cert. denied*, 112 L.Ed.2d 312, 111 S. Ct. 347 (1990).

twice before made such arguments and contentions to no avail.[2] What the record actually shows is that Petitioners failed to present a genuine issue of material fact, and that the facts and evidence presented to the District Court when analyzed under well-established law were simply not sufficient to sustain any of their claims.

Specifically, the District Court found that DH&S did not make any representations to Petitioners. Appendix to Petition at 13a-14a, 30a. In fact, no DH&S employee ever conversed with, or delivered any documents to, any of the Petitioners, much less solicited any investments from Petitioners. Appendix to Petition at 13a, 26a.[3] The District Court found that the mere fact that the auditor was aware that its client might solicit investors in the future is not sufficient. Appendix to Petition at 25a-26a. Further, the

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[2] There are numerous other assertions in the Petition that are either out of context, incomplete, or which refer to allegations in the complaint. Petition at 6-9. Such assertions are beside the point as far as this Petition is concerned because they relate to claims that a duty was breached, rather than to the central issue of whether there was a duty in the first instance. Petitioners mix these allegations with the concepts of duty and recklessness in their Petition in an effort to support their theory that foreseeability establishes a primary duty under Section 10(b). That argument by Petitioners, which is wholly without support either legally or factually, is addressed in detail by DH&S in Section B of this brief.

[3] In this regard, the undisputed evidence before the District Court was that DH&S' audit reports on LRI's financial statements expressly stated that they were representations by DH&S only to "the Board of Directors and Shareholders" of LRI, and each of those reports was delivered directly and exclusively to LRI.

District Court concluded that DH&S did not intend its audit reports to be representations to anyone other than LRI. Appendix to Petition at 30a. The District Court determined that DH&S' audit reports on LRI's 1982, 1983, 1984, and 1985 financial statements were issued before DH&S had any knowledge of LRI's solicitation of Petitioners and could not have been intended to be representations by DH&S to them. Accordingly, DH&S could not have intended its 1982 through 1985 audit reports to be representations to Petitioners. Appendix to Petition at 29a-30a.

Petitioners contend here, as they did in the courts below, that DH&S' audit reports on LRI's 1982 through 1985 financial statements were intended to be representations to Petitioners based solely on the fact that a 1982 auditor's memorandum prepared by DH&S discussed the fact that a particular potential investor (Greylock Partners, which is not one of the Petitioners) would be relying on a particular review report (not an audit) of DH&S during negotiations with LRI concerning a particular investment proposal in 1982. The District Court rejected this argument, recognizing that a specific memo in 1982 concerning DH&S' preparation of a specific report for LRI, for use by a specifically identified potential investor in connection with a particular investment transaction, is not sufficient evidence that DH&S intended future audit reports to be representations to "*any* potential venture capital investor at *any* future time," (Appendix to Petition at 26a, emphasis in original of District Court's order of April 1, 1992), including the Petitioners four or five years later.[4]

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[4] In fact, the opposite conclusion can be drawn. When DH&S

As to the 1986 report, two of the Petitioners, North Riverside and Heritage, have conceded that they could not have relied on DH&S' audit report on LRI's 1986 financial statements. Petition at 4. Both entities invested in LRI on December 31, 1986, three months prior to the issuance of that audit report. Thus, any reliance by them on DH&S' 1986 report was chronologically impossible. Petitioner Venturtech, which invested in LRI in June, 1987, after the issuance of DH&S' audit report on LRI's 1986 financial statements, does not make this concession. However, the District Court held that DH&S had no contact with Venturtech whatsoever and neither knew nor intended that its audit report on LRI's 1986 financial statements would be used in connection with any investment, or that it would be a representation to Venturtech. Appendix to Petition at 33a. Venturtech attempts to dispute this factual ruling by referring to four documents in the record, but has twice failed to convince a court that these documents raise any genuine issue of a material fact regarding whether DH&S knew of a pending investment in LRI by Venturtech and intended its 1986 audit report to constitute a representation to Venturtech in connection with Venturtech's investment decision.[5]

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rendered services specifically for utilization by LRI in connection with an investment, LRI and DH&S expressly noted it in their engagement agreement. The absence of such an acknowledgment between LRI and DH&S with respect to any of the audits complained of by Petitioners refutes their contention that it was foreseeable, let alone intended, by DH&S that any of its audit reports would be relied upon by Petitioners in connection with their investments in LRI.

[5] The District Court held just the contrary. Rather than establishing that DH&S knew of a pending investment by Ven-

Recognizing that there is no evidence that DH&S intended its reports to be representations to Petitioners, Petitioners nevertheless suggest that such audit reports should be deemed to be representations by DH&S to Petitioners because "Deloitte knew of LRI's capital raising efforts" and therefore should have foreseen that investors like Petitioners would rely on DH&S' audit report in making their investment decisions. Petition at 5. Petitioners further suggest that the District Court (i) ignored this evidence of "Deloitte's knowledge of LRI's capital raising efforts" in finding DH&S owed no duty to Petitioners, and (ii) essentially imposed a privity standard on an accountant's duty under federal securities laws. Petition at 18. Both of these contentions are incorrect.

A review of the record belies Petitioners' suggestions that the District Court overlooked evidence or that it established a privity standard. First, the District Court examined and rejected the concept that mere knowledge by an auditor that there might be future investments is enough. Appendix to Petition at 25a-27a. This finding is in accord with established authority. *See Frymire-Bernati v. KPMG Peat Marwick*,

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turtech in LRI in June, 1987, three of these documents establish that DH&S knew only that there were proposed investments in LRI which would close on December 31, 1986, *several months before* the issuance of its audit report on LRI's 1986 financial statements. Appendix to Petition at 33a. Petitioners did not make any argument to the District Court regarding the fourth document, LRI's March 1993 board minutes. Moreover, it is undisputed that Petitioners produced these minutes from their own files. These minutes were not present in DH&S' files nor do any of DH&S' audit workpapers or notes make any reference to the issues discussed in these minutes.

___ F.2d ___ , 1993 U.S. App. LEXIS 19657 (7th Cir. 1993). Second, the District Court reviewed in detail the evidence Petitioners presented concerning previous venture capital investments in LRI and concluded that—with the exception of a 1982 review report prepared with specific knowledge by DH&S that a particular investor, Greylock Partners, would rely on the review report in making an investment decision in 1982—"the record contains no evidence that DH&S knew that the financial statements prepared by it were distributed to, or used by, venture capital investors." Appendix to Petition at 27a.[6]

Simply put, what the District Court found was that there was no evidence that DH&S knew that its audit reports were to be distributed to or used by venture capital investors, participated in any LRI securities offering, made any representations regarding any such offering, communicated in any way with any of Petitioners in connection with the making of their

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[6] Petitioners also assert a theory of liability based upon their contention that DH&S failed to obtain management representation letters during the 1985 and 1986 audits. Petitioners argue that such alleged failures require a finding, as a matter of law, that LRI's financial statements be deemed to be representations of DH&S rather than LRI, despite the fact that it was LRI that later furnished its 1985 financial statements to Petitioners and its 1986 financial statements to Venturtech without the knowledge or participation of DH&S. While DH&S does not agree with Petitioners' characterization of the evidence, the particular facts are not germane to the Petition. Petitioners made their assertion in the District Court and in the Circuit Court without success. Petitioners offer no authority to support the theory. There is no such authority. Moreover, as set forth in detail above, the undisputed facts and the conclusions of the District Court show that there is no logic to the Petitioners' contention.

investment decisions, or possessed an intent to deceive anyone. Appendix to Petition at 12a-14a, 25a-27a. Section 10(b) does not impose any duty on DH&S under these circumstances that would give rise to either primary or aiding and abetting liability.

B. For Purposes Of A Primary Section 10(b) Claim, There Is No Authority, Much Less A Split Of Authority, As To Petitioners' Proposition That A Report Issued By An Auditor To Its Audit Client Is Deemed To Be A Representation Made To All Potential Future Investors.

Petitioners assert that if an auditor knows that its audit client may at some unspecified time in the future have a need for investment capital, then the auditor "should know" that the unknown future investors will rely on the audit report. According to Petitioners, it therefore follows that an audit report issued solely to the audit client, perhaps years before any actual investor appears, should *ipso facto* be deemed an affirmative representation by the auditor to the investor sufficient to create liability under Section 10(b). Petition at 18-19. The District Court properly rejected this theory. Appendix to Petition at 25a-27a. Petitioners reason for advancing this theory of virtually unlimited liability is obvious. Petitioners must circumvent the District Court's holding that DH&S made no representations to them and did not intend to deceive Petitioners or anyone else. The mere fact that an auditor knows that companies may in the future need investment capital (which Petitioners argue makes foreseeable both the existence of such investors and their reliance on the auditor's report) has not been determined by this Court or any Circuit Court to constitute the predicate for imposing liability

under Section 10(b). Thus, Petitioners' contentions do not present for review either a split among the Circuit Courts or a matter which has not been settled by this Court.

Rather than cite any cases in support of this attenuated "foreseeability" theory, and without any logical connection to their arguments, Petitioners leap to cases applying the recklessness standard to Section 10(b) claims involving affirmative representations. Indeed, Petitioners have admitted the critical fact which makes each of their cases inapposite here. They concede that "Deloitte did not solicit [Petitioners'] investments in LRI, nor did it help create a formal, published prospectus including its name and work." Petition at 20. This is a dispositive concession, particularly in light of the District Court's finding that DH&S did not have any communication with any of the Petitioners. Each of Petitioners' "authorities" involves a claim that a defendant either (i) prepared a report specifically for inclusion in an offering document directed to the plaintiff, such as a prospectus, or (ii) participated in soliciting the plaintiff's investment.

For example, in *Rudolph v. Arthur Andersen & Co.*, 800 F.2d 1040 (11th Cir. 1986), *cert. denied*, 480 U.S. 946 (1987), the plaintiff complained of an audit report which the auditor knew would be included in a prospectus to be directed to the plaintiff. In *Akin v. Q-L Investing, Inc.*, 959 F.2d 521 (5th Cir. 1992), the allegations were that the audit report was prepared expressly for distribution in a private placement memorandum to be directed to the plaintiff. In *Wiley v. Hughes Capital Corporation*, 746 F. Supp. 1264 (D.N.J. 1990), the plaintiff asserted that the auditor

prepared a report specifically for inclusion in a prospectus to be directed to the plaintiff. In *Ades v. Deloitte & Touche*, 799 F. Supp. 1493, 1495 (S.D.N.Y. 1992) (which was a motion to dismiss), the allegations before the court were that the auditor "consented to use of its . . . opinion . . . in various filings with the Securities and Exchange Commission." In *Fund of Funds, Ltd. v. Arthur Andersen & Co.*, 545 F. Supp. 1314 (S.D.N.Y. 1982), the audit client was a mutual fund, which by law must publish a prospectus containing audited financial statements.

In each of these cases, there were allegations that the defendant-auditor intended to make an affirmative representation to the plaintiff. Thus, the plaintiff's reliance on the audit report was not merely 'foreseeable,' as Petitioners contend.[7] It was intended. That

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[7] Even under Petitioners' theory of "foreseeability," Petitioners' claims would fail because the District Court found that DH&S did not know of any distribution of its reports to, or use by, venture capital investors. Appendix to Petition at 27a. The Seventh Circuit has recently analyzed a similar contention in *Frymire-Brinati v. KPMG Peat Marwick*, ___ F.2d ___, 1993 U.S. App. LEXIS 19657 (7th Cir. 1993). There, the court focused on the "in connection with" element of a Section 10(b) claim against an auditor. Vacating a jury verdict and dismissing the Section 10(b) claim against the auditor, the Court held, *inter alia:*

> Any auditor's opinion might be used in connection with the sale of securities, but most financial statements serve to assist existing investors who seek to know the status of their firm and desire to monitor the managers. To find the "connection" just because the managers, unbeknownst to the auditors, show the financial statements to some potential investor would abolish the requirement that the defendant's acts oc-

is quite different from this case where the District Court found that DH&S did not intend for its reports to be for the benefit of anyone other than its client (Appendix to Petition at 30a) and, moreover, did not even know that its reports were distributed to, or used by, any investors (other than a review report specifically for Greylock in 1982). Appendix to Petition at 27a.

The other cases cited by Petitioners as supporting their "foreseeability" theory involved information which, although not included in an offering document, was specifically intended by the defendant to be a representation to the plaintiff. For example, in *Sharp v. Coopers & Lybrand*, 649 F.2d 175 (3d Cir. 1981), *cert. denied*, 455 U.S. 938 (1982), the defendant accountants prepared a tax opinion for the specific purpose of its distribution by the client to potential investors. In *Sioux, Ltd. Securities Litigation v. Coopers & Lybrand*, 914 F.2d 61 (5th Cir. 1990), the auditing firm's partner in charge of the audit personally represented to investors that a contingent liability of the audit client would have no effect on the client's financial statements.[8] Thus, there is no ques-

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cur "in connection with" the purchase or sale of securities.

As in *Frymire-Brinati*, the District Court concluded that the ever present possibility of future investors is not enough to impose liability on an auditor. Appendix to Petition at 25a-26a, 31a.

[8] Petitioners' discussion of this case, however, does not reveal this critical fact, which is set out in a prior opinion in the same litigation. *See Sioux, Ltd. Securities Litigation v. Coopers & Lybrand*, 901 F.2d 51, 53 (5th Cir. 1990)("The plaintiffs . . . contend that Coopers & Lybrand's partner in charge of the audit

tion that each of these cases was predicated on the existence of an affirmative representation directly by the auditor to the investor.[9]

In stark contrast to the facts of each case cited by Petitioners, LRI was a closely held, non-reporting corporation. Its securities were never registered under the 1933 Act, or publicly offered, issued, or traded. Neither LRI's financial statements nor any related audit reports, including DH&S' audit reports complained of by Petitioners, were ever included in any registration statement, prospectus, offering circular, or private placement memorandum. Further, DH&S did not communicate with Petitioners and did not solicit Petitioners' investments in LRI. *See* Petition at 20. The District Court therefore found that DH&S made no representation to any of Petitioners.[10]

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assured them that the events [pertaining to the contingent liability] did not affect the validity of the . . . audit.").

[9] In discussing these cases, DH&S is not addressing whether the courts ruled correctly regarding the ultimate issues before them, but rather that the allegations and facts before these courts were distinguishable from those of the present case where the District Court held, and the Fourth Circuit affirmed, that there was no evidence that DH&S had any contact with Petitioners or consented to the use of its audit reports in any materials which it knew would be provided to Petitioners.

[10] The District Court found that at the time DH&S issued its audit report on the 1985 financial statements, dated April 11, 1985, it did not know about the December 1986 investment or its solicitation. The court similarly found that at the time DH&S issued its 1986 audit report dated March 20, 1987, it did not have any knowledge of the Venturtech investment which was made in June 1987, or its solicitation. Petition at 33a. Petitioners do not dispute any of these findings.

Thus, there is simply no Circuit Court authority to support Petitioners' theory that an audit report issued only to the audit client is deemed to be a representation by the auditor to all potential future investors in the audit client. Common sense compels the conclusion that an auditor must intend to make a representation to a potential investor before it can intend to mislead or deceive the investor by that representation. Indeed, the cases cited by Petitioners confirm this logic; each addressed primary liability claims involving an intended representation by the defendant to the plaintiff.

The only other authority Petitioners cite to support their foreseeability theory is dicta from *United States v. Arthur Young*, 465 U.S. 805 (1984), which Petitioners cite woefully out of context. In *Arthur Young*, the sole issue before this Court was the scope of the subpoena power of the Internal Revenue Service ("IRS") under 26 U.S.C. §7604. *Id.* at 807. The accounting firm was not a party to the original action and the IRS asserted no misrepresentation claims against it. The action involved tax, not Section 10(b), claims against the accountant's client. *Id.* at 817-18. This Court held that the accountant's workpapers were (i) relevant to issues raised by the IRS and (ii) not protected from discovery by any privilege. Thus, contrary to Petitioners' assertion, this Court's decision in *Arthur Young* was not the genesis of any new "watch dog" role for accountants, and in no manner held, or even implied, that accountants have a universal fiduciary duty to every person to whom its audit client provides its financial statements.[11]

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[11] Not only is Petitioners' assertion that public policy favors

C. There Is No Split Of Authority On The Elements Of An Aiding And Abetting Liability Claim As Presented By The Facts Of This Case.

The Petitioners also seek review of the decisions below with respect to dismissal of Petitioners' aiding and abetting claims under Section 10(b). The District Court granted DH&S summary judgment on those claims based upon its findings that DH&S had no fiduciary or special duty to the Petitioners (which Petitioners did not appeal to the Fourth Circuit), did not take any affirmative actions to assist the alleged fraud by LRI, and harbored no intent to deceive the Petitioners or anyone else. Struggling under the weight of those findings, the Petitioners seek to have this Court decide that a claim of some form of reckless conduct, without more, it sufficient to impose aiding and abetting liability under Section 10(b).[12] However, neither this Court nor any Circuit Court has held that reckless conduct alone, without either a fiduciary or other special duty owed by the defendant to the plaintiff or some affirmative action by the defendant to assist the alleged fraud, suffices

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placing "watch dog" responsibilities on auditors without authoritative support, it has already been considered and rejected by the Fourth Circuit, and other courts. *See, e.g., Schatz v. Rosenberg*, 943 F.2d 485, 493-494 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 1475 (1992); and *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir.), *cert. denied*, 498 U.S. 941, 111 S. Ct. 347, 112 L.Ed.2d 312 (1990).

[12] It is virtually impossible to determine where Petitioners' arguments relating to primary liability stop and its arguments relating to aiding and abetting start. Petitioners mix concepts and allegations in a fashion that blurs the essential distinctions between these two concepts of liability.

to impose liability for aiding and abetting under Section 10(b).[13]

This Court has twice held that Section 10(b) does not in and of itself impose a duty to disclose a primary violation of another. Instead, such a duty, if it exists, "arises from a relationship between the parties." *Dirks v. United States*, 463 U.S. 616, 658 (1983). More particularly, such a duty of disclosure exists if there is "a fiduciary or other similar relation of trust and confidence" between the plaintiff and the defendant. *Chiarella v. United States*, 445 U.S. 222, 228 (1980). In other words, the federal "securities laws do not impose a general duty to speak . . . these duties must be found in state law." *DiLeo v. Ernst & Young*, 901 F.2d 624, 628 (7th Cir. 1990), citing *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).

The Fourth Circuit, in *Schatz v. Rosenberg*, 943 F.2d 485 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 1475 (1992), expressly followed these precedents in holding that Section 10(b) does not impose a duty to disclose the misrepresentations of another unless there is a "fiduciary or other confidential relationship" between the plaintiff and the defendant. *Schatz*, 943 F.2d at 490. *See also Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1125 (7th Cir. 1990), *cert. denied*, 113 L.Ed.2d

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[13] This Court has accepted for review the question of whether there even exists a private cause of action for aiding and abetting under Section 10(b) by issuing a writ of *certiorari* in *First Interstate Bank of Denver, N.A. v. Pring*, 969 F.2d 891 (10th Cir. 1992), *cert. granted sub nom. Central Bank of Denver v. First Interstate Bank of Denver, N.A.*, 1992 WL 353224 (U.S.), and if such a cause of action exists, whether recklessness is an appropriate standard upon which to predicate aider and abettor liability under Section 10(b).

250, 111 S. Ct. 1317 (1991) ("[G]eneral duties to speak do not find their source in securities laws, . . . but instead 'must come from a *fiduciary relation* outside securities laws.'"—emphasis added), quoting *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 496 (7th Cir. 1986) (emphasis added).

In the present case, the District Court found as a matter of law that there was no fiduciary or other special relationship between DH&S and Petitioners. Appendix to Petition at 13a. Petitioners did not challenge that ruling on appeal to the Fourth Circuit. In the absence of a fiduciary relationship between DH&S and Petitioners, the rulings of *Dirks*, *Chiarella*, and *Schatz* compel the conclusion that DH&S owed no duty to Petitioners.

1. Absent A Duty Of Disclosure, Petitioners Had To Prove That DH&S Acted With High Conscious Intent And A Specific Motivation To Aid A Fraud In Order To Prevail On Their Aiding And Abetting Claims.

The Fourth Circuit has held that in the absence of a duty to disclose, the level of scienter necessary to impose aiding and abetting liability under Section 10(b) is "high conscious intent" and a "conscious and specific motivation" to assist the fraud. *Schatz*, 943 F.2d at 496, citing *IIT v. Cornfeld*, 619 F.2d 909, 925 (2d Cir. 1980); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 97 (5th Cir. 1975); and *Martin v. Pepsi Cola Bottling Co.*, 639 F. Supp. 931, 934-45 (D. Md. 1986). The trial court concluded that DH&S had no such intent, finding that there was no evidence "from which a juror could conclude that DH&S deliberately shut its eyes to the truth [or] intentionally failed to conduct a proper audit." Appendix to Petition at 14a.

Contrary to Petitioners' suggestion, the rulings below were squarely within the holdings of the Circuit Courts which have addressed the situation presented by the case at bar—*i.e.*, allegations of a failure to disclose, but no finding of a fiduciary or other special relationship. *See Cleary v. Perfectune, Inc.*, 700 F.2d774, 777, 779 (1st Cir. 1983)(noting that "courts generally have held that in the absence of a duty of disclosure, a defendant should be held liable as an aider and abettor only if plaintiff proves the defendant had actual knowledge of the improper activity of the primary violator and his role in the activity," and dismissing the plaintiffs' aider and abettor claim because they "failed to produce any evidence from which it might be inferred that defendants' inaction was consciously intended to further the [primary violator's] allegedly fraudulent activity"); *IIT v. Cornfeld*, 619 F.2d 909, 925 (2d Cir. 1980)("When it is impossible to find a duty of disclosure, an alleged aider-abettor should be found liable only if scienter of the high 'conscious intent' variety can be proved."); *Monsen v. Consol, Dressed v. Beef Co., Inc.*, 579 F.2d 793, 799 (3d Cir.), *cert. denied*, 439 U.S. 930 (1978)(if there is no duty, inaction may provide a predicate of liability only where "plaintiff demonstrates that the aider-abetter consciously intended to assist in the perpetration of a wrongful act"); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 97 (5th Cir. 1975)("When it is impossible to find any duty of disclosure, an alleged aider-abetter should be found liable only if scienter of the high conscious intent variety can be proved."); *Metge v. Baehler*, 762 F.2d 621, 625 (8th Cir. 1985), *cert. denied*, 474 U.S. 1072, 88 L.Ed.2d 804, 106 S.Ct. 832 (1986)("Simply put, in the absence of a duty to act or disclose, an aider-abettor case

predicated on inaction of the secondary party must meet a high standard of intent" *i.e.*, "high 'conscious intent'."); *Harmsen v. Smith*, 693 F.2d 932, 934 (9th Cir. 1982), *cert. denied sub nom. Smith v. Harmsen*, 464 U.S. 822, 78 L.Ed.2d 97, 104 S. Ct. 89 (1983)(plaintiff must prove "*knowledge* by the alleged aider and abetter of the wrong and his or her role in furthering it"); *Farlow v. Peat, Marwick, Mitchell & Co.*, 956 F.2d 982, 989 (10th Cir. 1992)("if there is no fiduciary duty . . . the scienter requirement increases so that [plaintiff] needs to show that [defendant] acted with actual intent."); *Schneberger v. Wheeler*, 859 F.2d 1477, 1480 (11th Cir. 1988), *cert. denied*, 490 U.S. 1091 (1989)("a defendant who is not under any duty to disclose can be found liable only if he acts with a high degree of scienter, that is, acts with a 'conscious intent' to aid the fraud."); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 35-36 (D.C. Cir. 1987) ("in the absence of a duty to disclose, there is no liability unless the defendant 'manifests a conscious intention to further the principal violation."); *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 496 (7th Cir. 1986) (plaintiff must show that the alleged aider and abetter "committed one of the 'manipulative or deceptive' acts").

The rationale supporting the requirement that, absent a duty of disclosure, a high level of scienter must be shown was clearly stated by the Third Circuit:

> [K]nowledge of the underlying violation is a critical element of proof in aiding and abetting liability, for without this requirement, . . . [professional service] organizations would be virtual insurers of their customers against security law violations. Culpability of some

> sort is necessary to justify punishment of a secondary actor, and mere unknowing participation in another's violation is an improper predicate to liability.

Monsen v. Consol. Dressed Beef Co., Inc., 579 F.2d 793, 799 (3d Cir.), *cert. denied*, 439 U.S. 930 (1978).

The *only* Circuit Court authority which Petitioners even contend holds that recklessness will satisfy the scienter requirement for aider and abettor liability under circumstances similar to the case at bar is *Admiralty Fund v. Hugh Johnson & Co.*, 677 F.2d 1301 (9th Cir. 1982). *See* Petition at 15. This reliance is misplaced. The excerpt from *Admiralty Fund* quoted by Petitioners is a general statement made without any discussion of the duty issue.[14] In fact, there is no discussion whatsoever in the *Admiralty Fund* decision about whether the alleged aider and abettor did, or did not, have a duty relationship with the plaintiff. Moreover, subsequent to *Admiralty Fund*, the Ninth Circuit held that a plaintiff must prove "*knowledge* by the alleged aider and abettor of the wrong and his or her role in furthering it." *See, Harmsen v. Smith*, 693 F.2d 932, 934 (9th Cir. 1982) (emphasis in original), citing *IIT v. Cornfeld, Monsen*

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[14] It also should be noted that the *Admiralty Fund* court cites in support of the quoted statement the Fifth Circuit's decision in *Woodward v. Metro Bank of Dallas*, a case which expressly held (and is often cited for) the following:

> When it is impossible to find any duty of disclosure, an alleged aider-abettor should be found liable only if scienter of the high "conscious intent" variety can be proved.

Woodward, 522 F.2d at 97.

v. Consol. Dressed v. Beef Co., Inc., Woodward v. Metro Bank of Dallas—all of which stand for the proposition that absent a fiduciary duty, a plaintiff must show that the alleged aider and abettor acted with conscious awareness of the fraud.

In the present case, the District Court in its April 1st order held that:

> The plaintiffs have neither alleged nor proven that DH&S possessed such a state of mind. The court cannot find in the record, and the plaintiffs have not presented, any evidence indicating that DH&S conducted its audits with a "high conscious intent" to aid a securities violation.

Appendix to Petition at 39a. It went on to state in its May 15th order that "there is [no] evidence from which a juror could conclude that DH&S deliberately shut its eyes to the truth and intentionally failed to conduct a proper audit." Appendix to Petition at 14a. Simply put, the District Court correctly held, and the Fourth Circuit has affirmed, that without any evidence of a conscious intent by DH&S to aid an alleged fraud by LRI, summary judgment in favor of DH&S on Petitioners' secondary Section 10(b) claims was compelled by the decisional law. There is no split of authority, as Petitioners suggest, which would provide a basis for the grant of a writ of *certiorari*.

Petitioners, unable to come forward with any reason why this Court should grant *certiorari*, attempt to bootstrap themselves into *certiorari* by invoking another case before this Court. Petitioners assert that *First Interstate Bank of Denver, N.A. v. Pring*, 969 F.2d 891 (10th Cir. 1992), *cert. granted sub nom. Central Bank of Denver v. First Interstate Bank of Den-*

ver, N.A., 1992 WL 353244 (U.S.), addresses "essentially the same arguments made by Deloitte—that recklessness is not sufficient scienter when there is no duty to disclose." Petition at 16. However, the allegations in *Pring* are fundamentally different from the present case.

2. In *Pring*, The Allegations Of Secondary Liability Under Section 10(b) Are Fundamentally Different Than Petitioners' Allegations In The Present Case.

In *Pring*, the plaintiffs sought recovery of losses incurred upon the default of development bonds which the plaintiffs had purchased. They asserted Section 10(b) aiding and abetting claims against Pring, a principal of the developer, and against the indenture trustee for the development bonds. The plaintiffs alleged that Pring remained silent with respect to the alleged fraud with an "actual intent to aid the primary violation." *Id.* at 899. In the present case, the District Court found no evidence that DH&S intended to deceive anyone or intended to aid anyone else's deception. Appendix to Petition at 14a, 39a. Thus, the claims against Pring are not relevant here.

The plaintiffs in *Pring* also alleged that the indenture trustee aided and abetted the alleged primary Section 10(b) violation. Specifically, they asserted that the trustee "assisted the primary violation by *affirmative action*" by agreeing to delay an independent review of an appraisal of the property being developed with the bond proceeds. *Id.* at 902 (emphasis in original). Therefore, the issue before the Tenth Circuit was: "[W]hen an alleged aider and abettor owes no duty to plaintiffs, *but takes affirmative action that*

assists the primary violation,[15] does recklessness satisfy the scienter requirement for aiding and abetting liability?" *Id.* at 902 (emphasis added). The District Court found, and the Fourth Circuit affirmed, that there was no evidence of any such affirmative action by DH&S in this case. Appendix to Petition at 39a.

The Tenth Circuit's opinion in *Pring* recites various cases demonstrating the type of affirmative assistance which may be actionable under Section 10(b). Each example was predicated on a direct interaction between the plaintiff and the alleged aider and abettor. *See, e.g., Levine v. Diamanthuset, Inc.*, 950 F.2d 1478 (9th Cir. 1991)(defendant trust company interacted directly with defrauded investors by, *inter alia*, making representations and issuing confirmations); and *FDIC v. First Interstate Bank*, 885 F.2d 423 (8th Cir. 1989)(defendant bank processed funds and administered accounts of plaintiffs). Here, Petitioners concede

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[15] Consistent with the Fourth Circuit's holding in *Schatz* and the holdings of the other Circuit Courts discussed above, the Tenth Circuit recognizes that in order to maintain a claim for aiding and abetting liability under Section 10(b), the plaintiff must show that the alleged aider and abettor provided substantial assistance with respect to the primary violation, not simply to the person committing the violation. As explained by the Fourth Circuit in *Schatz*:

> [T]he "substantial assistance element requires that a lawyer must actively participate in soliciting sales or negotiating terms of the deal on behalf of the client to have "substantially assisted" a securities violation. In other words, a plaintiff must prove that a defendant rendered "substantial assistance" *to the primary securities violation*, not merely *to the person* committing the violation.

Schatz, 943 F.2d at 497 (emphasis added).

that DH&S did not solicit or negotiate the sale of any LRI securities to them. Appendix to Petition at 13a. Indeed, there was no communication of any nature between DH&S and Petitioners. *Id.* Therefore, the issues presented for review in *Pring*, and the cases cited therein with respect to "affirmative assistance," are inapposite here.

CONCLUSION

The grant of summary judgment by the District Court and the affirmance by the Fourth Circuit are consistent with the decisions of this Court and well supported by the record. There is no special and important reason for this Court to consider and no purpose would be served by this Court's review of the opinions below. The Petition for a Writ of *Certiorari* should therefore be denied.

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Respectfully submitted,

JAMES T. WILLIAMS, JR.*
JEFFREY E. OLEYNIK
DANIEL M. SROKA
BROOKS, PIERCE, MCLENDON,
HUMPHREY & LEONARD
Suite 2000 Renaissance Plaza
230 North Elm Street (27401)
Post Office Box 26000
Greensboro, NC 27420
(919) 373-8850

Attorneys for Respondent
**Counsel of Record*

Of Counsel:

BARBARA A. MENTZ
Associate General Counsel
DELOITTE & TOUCHE
1633 Broadway, 9th Floor
New York, NY 10019-6754
(212) 492-3884